DOW THEORY LETTERS INC.

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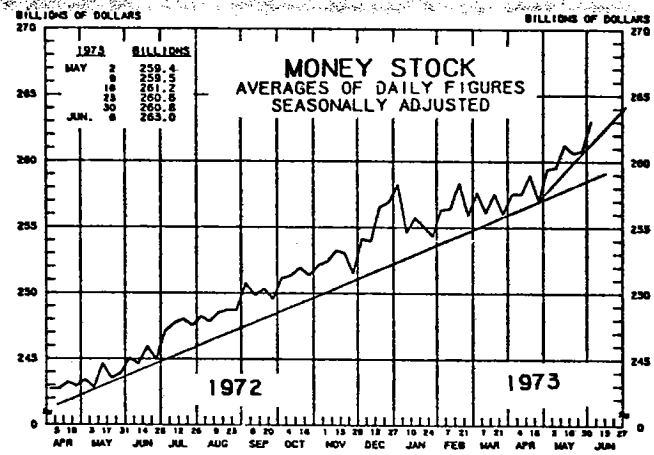
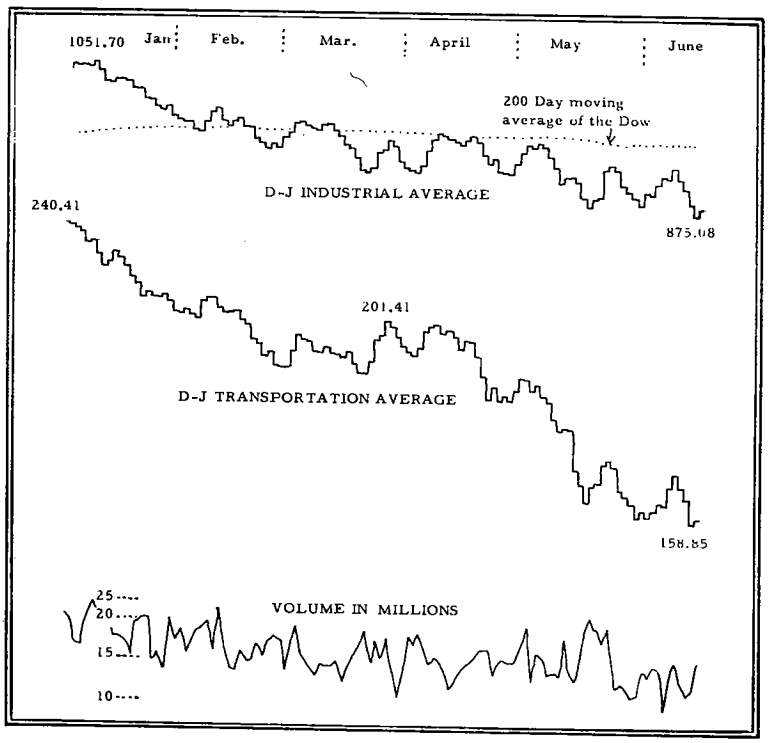
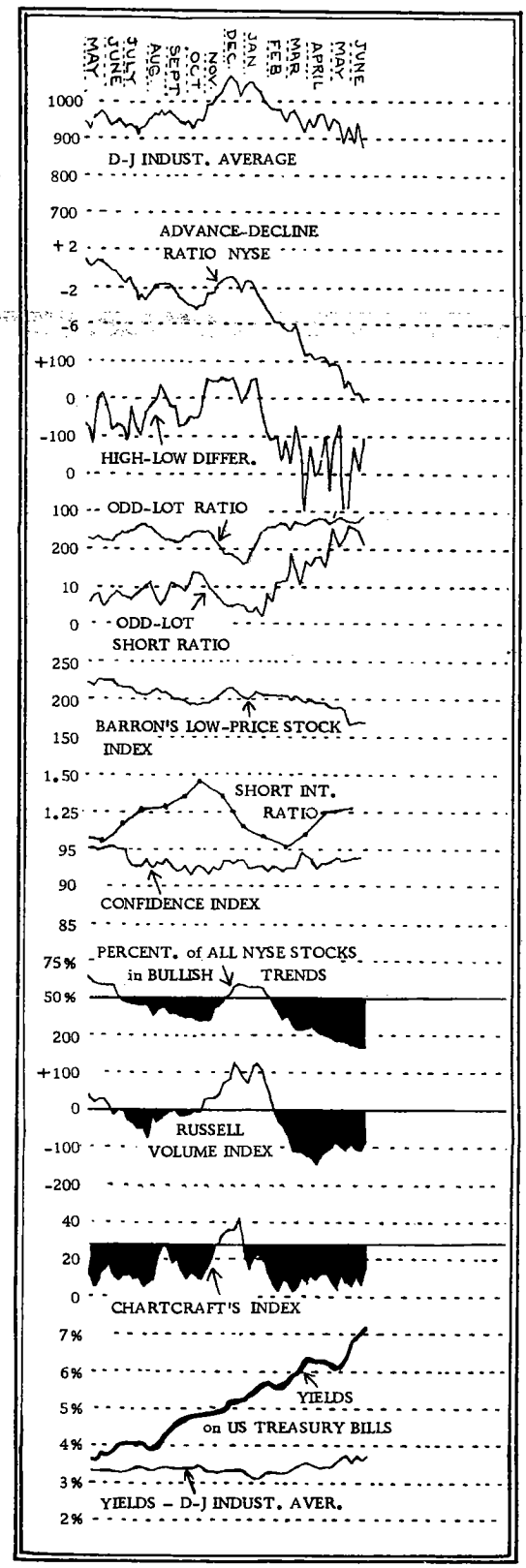
THE MARKET: There's an old saying that "Figures don't lie, but liars can figure." I show (below) the latest figures for the US money supply which the Federal Reserve Bank of St. Louis kindly mails to me each week. The steep rising trendline, which has been in force for lo these many months, has given way to an even steeper ascending trendline (since April). In the face of the still-ballooning money supply, one can only wonder at the publicly-admitted confusion of such stalwarts as Herbert Stein, President of the Council of Economic Advisors, or George Schultz, our Treasury Secretary.

The 60-day price freeze slapped on the nation by Mr. Nixon is widely conceded to be a bid for voter (particularly farm and union voter) popularity, while it also







serves to put the squeeze on corporate profits. With the money supply running wild, the pathetic spectacle of a short-term lid on prices is tantamount to trying to weigh down a six-ton elephant with an eiderdown sleeping bag.

In reading the dozens of investment services which arrived here early this week, I was struck by the "computing," the agony and the hand-wringing which is now taking place as the various analysts attempt to "call" the next major upward movement. The reason for the agonizing is clear enough. In the majority of cases, these gentlemen had not foreseen the severity or relentlessness of the long decline (which actually began for many stocks during 1971), and they are now in the position of "hoping" for a bottom, that elusive bottom which some day must come. At this point most of the "model stock portfolios" in the services have either been quietly dropped or else they have been "hedged" with theoretical shorts.

I am also struck by the small number of services which, throughout the market collapse and the gold rise, have persistently refused to recommend shares in the yellow metal. As far as I can see, there is still a terrible "fear and loathing" regarding the gold shares. Thus, despite the extraordinary rise of the past two years, purchase and retention of golds must still be classified in the realm of "contrary opinion."

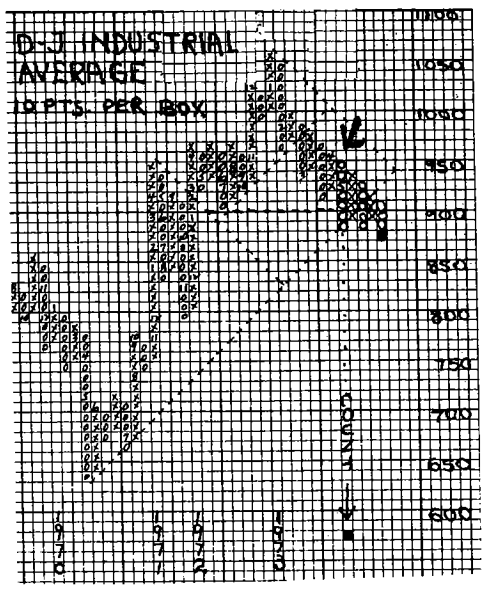
As to the market itself, the week began on a note of high drama, and I must say that Monday (June 18) presented some of the "heaviest" technical action I have seen in 25 years of watching Wall Street. On that day the D-J Industrial and Transport Averages broke to simultaneous new lows (Industrials to their lowest level in 18 months, Transports to their lowest level since December 1970). As veteran readers know, simultaneous penetration of preceding points by the Averages implies penetration with authority and force. On the same day, the Utility Average came within 3¢ of a new 1973 low.

As if that was not enough, June 18 saw the advance-decline ratio sink to its lowest point of the entire bear market (actually its lowest since the 1940's), and the Primary Trend Index also tumbled to its lowest level since I have been computing data for this proprietary index. In brief, the market was shattered by the action of June 18, with the coup de grace (if one was needed) being a 1973 low for bellwether General Motors, a break which took GM to its lowest level since 1970 (along, I might add, with Ford and Chrysler). June 19 (Tuesday) saw a 6 point rally in Industrials with breadth down, no new highs and 229 new lows. The next day (June 20) produced a puzzled, almost "shellshocked" market, groping for a trend amid the wreckage.

Much significance is attached to the relatively low volume which has accompanied the 1973 decline. It should be remembered, however, that although it takes expanding volume (buying) to move stocks up, those same equities can "drop of their own weight" (as they quietly hit the bids of the downside). I am reminded of a time in 1946 when I was watching the market slide off from its 212 (Dow) bull market peak on low volume. "It doesn't look too bad with this low volume," I announced to a veteran trader in the Bache boardroom. "My boy," he drawled, "before this downer is over, you'll see all the volume you want." He was right.

Despite the rather horrendous action of June 18, it is well to try to get out of the emotional realm and into the cold world of the probable. For those who insist on a short-term crystal ball, I must admit that I have a few conflicting "signs" at this juncture. For instance, Will-Go, which has had a good record of calling trading turns (see Letter 563, page 4) indicates that we should have a pretty impressive rally beginning around the early part of July (give it a week or so one way or the other).

On the other hand, my 10 point, 30 point reversal chart (point & figure, of course) gave a major sell signal at 11 A.M., June 18, when the Dow Industrials hit 880 on an hourly basis. I am updating the P & F chart which appeared in Letter 564, and the solid black box identifies the 880 point, which was hit June 18. This downside action smashes a so-called "triple bottom" (the triple bottom is formed by the three zeros at the 890 level. Furthermore, note that the "right shoulder" (arrow) of this massive "head-and-shoulders" top formation has assumed the form of what I term a "ski slope" or "sliding away" structure. The breakdown from this type of weak pattern (which occurred on June 18) can lead to a severe straight-down collapse. The sloping "right shoulder" (arrow on chart), which is actually composed of series of lower peaks and bottoms, is indicative of a steady shrinking in demand for stocks but with an absence of any massive increase in selling pressure. However, selling pressure (in the face of steadily lower prices) can pick up at any time in this kind of formation, and of course this is what ultimately brings in the heavy volume. (Chart courtesy of Chartcraft, Larchmont, NY 10538)



MOST-ACTIVE STOCKS: I have presented many studies of the "most-active stocks" index. During any given day, approximately 15% to 30% of the volume is produced by the 15 most active NYSE issues (these are listed in many newspapers

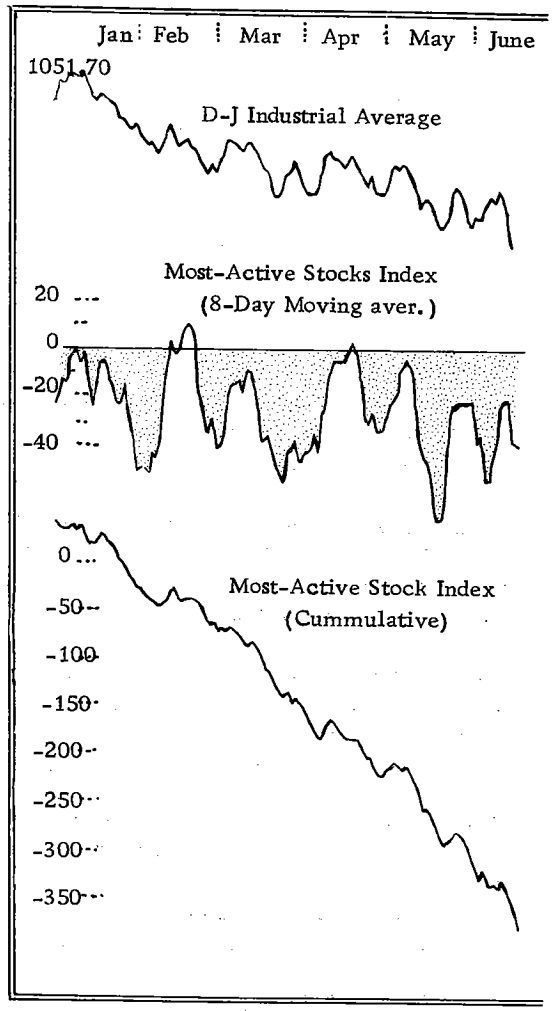
daily). In general, this concentration of interest in the volume leaders is indicative of the buying or selling proclivities of "big money" and investment money. A study of the most-active index (MAS) indicates that MAS usually leads the rest of the market in direction. In other words, where big money goes, the rest of the market generally follows. And MAS shows us where big money is going.

I have commented on numerous occasions (Letters 553, 558, 564) that the MAS during 1973 was putting on as poor a performance as I have ever seen. That statement, unfortunately, still holds true as this report is written.

The accompanying chart shows the Dow Industrials and two MAS indices on a daily basis. The first index is the one which has appeared here before. It is the daily plurality of the most-active stocks, arranged on an 8-day moving average. For instance, if on a given day 8 stocks on the most-active list declined while 4 advanced (3 were unchanged), the index reading for the day would be minus 4. The minus four would be incorporated in the 8-day moving average.

Note that except for 3 days (!) during February and one day in April, the MAS has remained on the minus (distribution) side of zero throughout 1973. This is an unbelievably bad reading. It suggests persistent, unabated selling of shares by investment money.

I have not been totally satisfied with the 8-day moving average of MAS, since it does not pin-point preceding levels of accumulation or distribution. Therefore, I have developed a second MAS index which is a cumulative line or an advance-decline index of the daily most-active stock tabulation. There, the incredibly poor action of the most-actives is brought into perspective. What the cumulative most-active index (CMAS) shows is that on a trend basis there has been an almost straight-line collapse in interest in the volume leaders.



I expect CMAS to prove very valuable during future months, and in time I believe it will be used as one of the "standard" technical indicators. For instance, ultimately we will see an upturn of CMAS and a series of rising zig-zags. This will imply an important upward correction underway. So far in 1973, however, CMAS has proved very easy to follow and to "read." And the reading has said only one thing, "lower prices ahead."

GOLD (cont') The previous two articles discussed some of the reasons for owning gold. In the last report I showed why it has taken so long for the public to become interested in gold, why 30 years of anti-gold propaganda has kept them out, and why even the institutions have stayed out of one of the most profitable moves of the past few years. And the fact is that the anti-gold propaganda goes on. Just a few weeks ago Treasury Secretary Schultz stated that the dollar's weakness was "a puzzling matter." That same day he asked for a $20 billion boost in the national debt ceiling (boosting it to $485 billion!). How Schultz could be puzzled by the dollar's weakness is a problem with such frightening connotations that it boggles the mind. The mystery is not why gold has tripled in price over the past few years; the mystery is what kind of reasoning foreigners used over the past few years to hypnotize themselves into holding dollars. As the old saying goes, "Hope springs eternal..."

Let us assume (and this is a basic tenet of Dow's Theory) that a trend once started runs to conclusion. What trends do we have in the US (monetarily speaking)? Here are established trends that I see. (1) We have a trend of inflation. It is the Keynesian philosophy, modified to fit today's ambitious political desires. The original Keynesian thesis: Deficits during bad times, pay off during good times. The "new" thesis: Deficits during bad times, deficit during good times. Dollars are now printed to "fit" the nation's "needs." (2) We have a trend towards trying to control everything. This means that the Government always resists fundamentals of supply and demand, while attempting to "fix" problems via legislation. (3) We have a trend of attempting to "get rid of gold." If you can't get rid of it, then ignore it. When the free market price of gold triples in two years and the dollar drops to 33% of its 1971 gold "value," simply state that the "evil speculators" have been manipulating the markets. Above all ignore the true meaning of gold.

My conclusion is that all these trends are fated to continue. As each crisis arises, the Government does as little as it can get away with in order to get the critics off its neck. Under these circumstances the public is gradually becoming educated, and therefore speculation against the dollar is bound to increase. Ultimately, the speculation will reach a climactic or explosive

 stage. At that time, there will be a world panic out of paper dollars — and into gold. Such a move will tear the fabric of the nation to pieces. It will wreck the economy. It will put the US's "will to live" to its greatest test since World War II.

To my mind, the question for all my readers is — "How do we hedge (protect ourselves) against a further continuing collapse of the dollar?" First I want to list a few avenues that I believe will not work (from here on) as the final crisis nears, and as the world sinks towards depression.

(1) Art collecting will not work. To my mind, the mania for "works of art" is now comparable with the "Tulip Mania" of the 17th century. I have seen art prices go up, I have seen them go down. The current art craze is one of the most flagrant examples of over-speculation in the world today. It would not surprise me to see art "investments" drop anywhere from 50% to 80% during the next five years.

(2) Real estate and houses: This is the second most flagrant area of over-valuation. In my opinion, much of the real estate price structure is based on a massive and extended loan-structure plus dreamy projections and population-boom fantasies. Add a generous sprinkling of the "greater fool theory" ("there's always a greater fool who will buy my real estate at a higher price") and you have it, a set-up for a wide-open real estate bust during the next five years.

(3) Businesses: I believe that many marginal and poorly run businesses will go under during the next five years. This includes many franchises, motels, fast food restaurants and most certainly many luxury-oriented companies. I have been saying that Americans are loaded with things they don't need (many of which don't work), purchased with money they don't have, and financed at interest rates they can't afford.

It is my belief that from here on there will be a gathering recognition that the way to financial survival lays with gold. Just as Watergate blew the political rottenness out into the open, the crumbling of the dollar and the destruction caused by inflation will blow the economic rot out into the open. As that occurs, people will want the safety of fundamentals, of basics, and the time-honored basic (intrinsic value) underlying money is gold.

Much has been written and said regarding Watergate as the catalyst which has set off the recent run against the dollar. My charts show that the "run" against the dollar has been going on for a long time, and Watergate is just more of the same. However, I do think Watergate is doing one thing, it is showing us the character and the quality of leadership this nation has fallen victim to. It is showing us where our leaders are, how they think and what they concern themselves with. And if that isn't enough to set off a run on the dollar, I don't know what is.

If we assume that my predictions regarding a mass movement to gold (as outlined in the two preceding articles) comes to pass, the question is, how can the US citizen (who is forbidden by law to own gold bullion) take a position in gold? There are a number of possibilities and I will briefly outline them.

(1) You can own placer gold, that is gold dust nuggets, or gold flakes as they appear in nature from river beds, etc. This is hard to come by and the catch is that its fineness (gold content) is not certain. Thus, an "ounce" of gold nuggets may contain perhaps 3/4 of an ounce of pure gold.
(2) You may own gold coins, and in most cases gold coins are legal to own (US gold coins minted prior to 1934 are legal).
(3) You can own and even work a gold mine, but this is rather impractical for my average reader.
(4) You can own shares in gold mines which (preferably) are listed on a recognized stock exchange.

I will discuss briefly the area of gold shares in this report. In the next report I will discuss gold coins. But as usual, I will present ideas and areas for further study. I have never promised readers that they would be getting weekly tips on the market. I insist that readers must do some work, which also means that your broker must work for you. This is the kind of market that separates the hard-working, honest, imaginative broker from the "good time Charlie," the bull market buccaneer and the smiling order-taker.

First, it is well to realize why people buy South African shares. Basically, S. Africa is where the gold is, perhaps 80% of the Free World's gold. The rest is in Canada, with a small portion in the US, represented by our largest mine, Homestake. Actually, all earth contains gold traces, but when I say "where the gold is," I mean where it is in commercial quantities and in deposits which are available.

Opinions regarding which golds to hold are as varied as there are gold enthusiasts. Gold shares are subject to dozens of variables, including politics, taxes, government edicts, racial tensions (S. Africa), strikes, fires, floods, wages, world conditons, and of course the price of gold itself. No buyer of gold shares can protect himself against all these variables. But some protection against some of these variables may be obtained through diversification.

We can diversify as to geography and as to quality. I cannot tell any subscriber how to diversify. As a rough idea, perhaps 1/3 of your golds should be in Canada, 2/3 in S. Africa

And although I am not going to do your homework or your broker's, I can offer some suggestions. The S. African mines offer by far the best values in terms of gold assets per mine and as far as dividend yields. Canada offers an absence of racial problems. In Canada we have Campbell Red Lake (top quality), Sigma Mines (good, small mine), and Dome Mines which owns 57% of Campbell, 63% of Sigma, plus large holdings in Mattagami Lake Mines, Canada Tungsten Mines and Dome Petroleum (plus a 1.25% interest in Panartic Oils). I consider Dome, Campbell, and Sigma all good holdings.

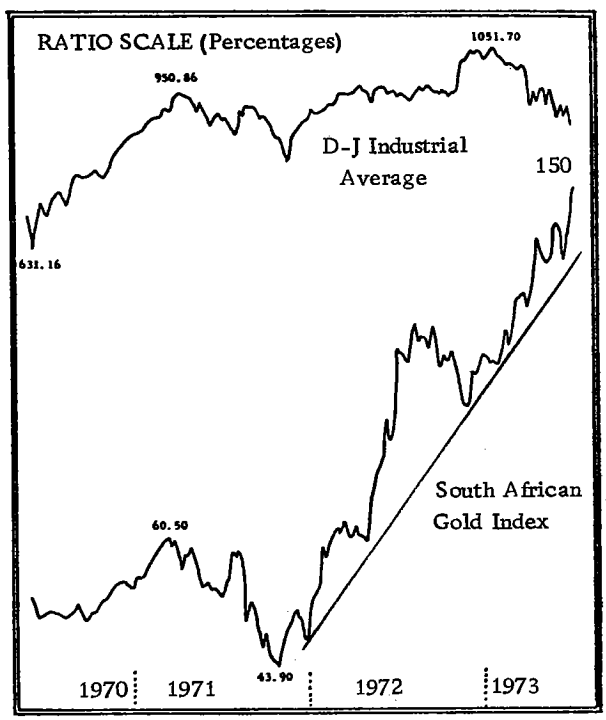
I happen to believe that within a year or so (when the public begins to "want" the gold shares) there is going to be a large and growing interest in the "cheap" or speculative gold stocks. Most of these vary in quality and should be researched carefully by your broker. Following are some "cheapies" I like. East Malartic, Pamour Porcupine, Royal Aggassiz, Agnico-Eagle, Goldex, Mentor Exploration, Camflo.

Next we turn to the S. African shares, the world's monster gold producers. Here we have a number of newer or long-life mines such as East Driefontein, Hartebeestfontein, Elsburg, Vaal Reefs, Kloof, President Steyn. They could be excellent high quality investments; some are not yet on a dividend basis. Then we have the older mines, many with high dividend yields such as President Brand, Free State Geduld, Western Holdings, West Driefontein, Bracken (low quality), Welkom, Western Areas.

Rather than drive readers crazy with names, I am going to list some of the largest holdings in ASA Ltd.'s portfolio. As readers know, ASA is a famous NYSE listed investment company which holds large quantities of S. African mine shares. ASA has proved itself expert in picking the winners, and here are some of their biggest current holdings. West Driefontein, world's largest gold producer, Vaal Reefs, fast becoming the new world's leading producer, East Driefontein, recently in production with a very long life (perhaps 50 years), Kloof, long recommended here, life expectancy 30 years and Winkelhaak (with 20 years life expectancy), South Vaal (new mine) and President Steyn (long recommended here, a stock which has tripled in value for those of us who bought it a few years ago).

I have a study which presents "intrinsic values" for S. African gold mines based on $120 gold. The following mines would seem to be particularly "undervalued" at this time: Bracken, Doornfontein, Free State Geduld, Hartebeestfontein, Western Deep, Winkelhaak.

It is ironic, but often those closest to investments cannot see the forest for the trees. This has been the story among S. African investors, and for years I read little of a bullish nature out of S. Africa regarding the mines. In fact, I believe that a good deal of the supply of S. African gold shares which have been offered over the past few years has come from the S. Africans themselves. Certainly, not even the most optimistic Africans envisioned $110 or $120 gold during 1973 (reports a year ago "projected" earnings at $70 gold or less).

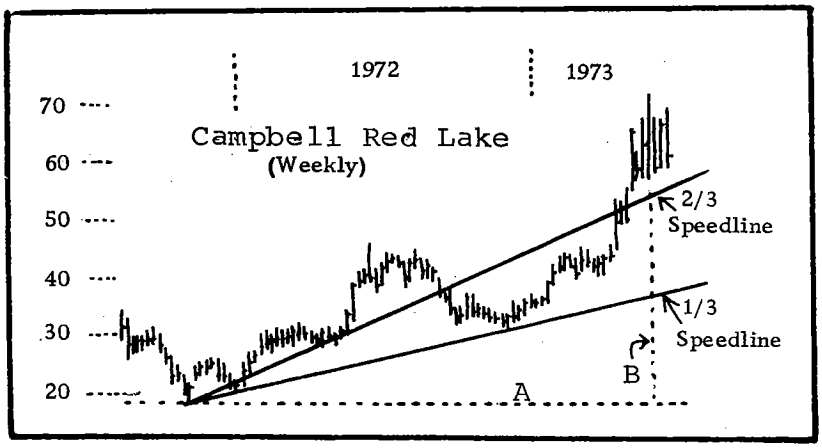


The Keynesian but highly influential London Economist surprised me last week by actually suggesting a few gold shares for possible (you should excuse the expression) purchase. Following is a clip from the June 9 Economist regarding President Brand (recommended here for years at 10 and under and now bid at 22 and still an interesting buy.

> At the other end of the industry President Brand is a big mine with a longer life and wide popularity among international investors. It has substantial uranium reserves, and built a new extraction plant for the uranium boom that never came. With the Americans talking themselves into an energy shortage, those assets could soon take on a new value.

At the right I have included my chart of the Dow and the South African Gold Index (figures available from Barron's weekly). This massive rise is holding beautifully above a rising trendline, and the chart shows how an investment in the gold shares and in the Dow would have done on a comparative basis since 1970. Obviously, the gold move has been one of the real investment

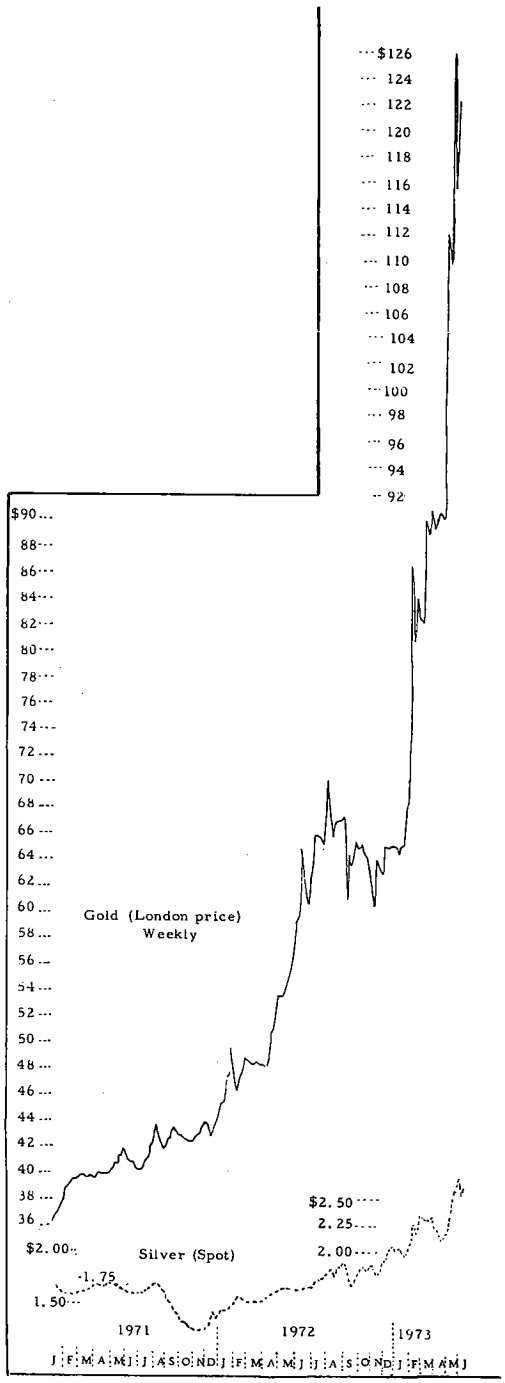
opportunities of the past five years, and the advance had everything going for it: disbelief, contrary opinion, a sold-out group, non-public participation, a bet that the US Government would do everything wrong, and the lessons of 5,000 years of history. What more could we ask for? Oh yes, add periodic denials from the US Treasury as an extra plus in the whole picture.



TECHNICAL AID: I have been receiving many letters regarding the current correction in gold shares. Edson Gould, well-known analyst ("Findings and Forecasts") developed a system some years ago which can be extremely helpful in gauging the trend of a stock (or an average). I have demonstrated with a chart of Campbell Red Lake (CRK). The chart must be drawn to standard arithmetic scale (not ratio scale). First, run a horizontal line (A on chart) extending out from the beginning of the movement. Then run a vertical line (B) from the peak price of the stock to the base at A. Then, simply divide the line B in three equal sections with a mechanical engineering divider. Finally, run two lines from the beginning of the movement to the 1/3 and the 2/3 marks on B. These will be the two "speedlines," the 1/3 and the 2/3 speedline.

In a strong movement, any correction will hold above the 2/3 speedline (as CRK has been doing so far). But if the stock breaks below the 2/3 speedline, it will often test the 1/3 speedline. If it breaks the 1/3 speedline, the stock has probably reversed its major trend. As a rule, if the stock holds persistently above the 2/3 speedline during a correction it is showing outstanding strength, and it will not be long before the stock rallies to new highs. As soon as a new high peak is formed, a new set of speedlines may be drawn. The opposite technique may be used during declines, and here too the results can be very useful. (I might add that so far all the listed NYSE gold shares have been holding above their 2/3 speedlines during this correction).

On this page I also show the chart of Gold and Silver, and a spectacular chart it is. Many people ask me why I don't talk more about silver, and here I must admit to a blind spot or a prejudice. Silver is not a monetary metal, it is not used to back currency. True, it is a precious metal, it has been called the "poor man's gold." I have, in the past, recommended a few silver stocks and even the Sunshine convertible bonds. And I know there is an historical (but widely variable) relationship between the price of gold and silver. Actually, I keep another chart of gold and silver (ratio scale, and I will publish it soon). That chart shows that silver is tending to keep up with gold on a percentage basis (but not quite making it). At any rate, I must confess that I simply cannot get "excited" about silver. I'd like to, but I can't (is it because I don't like silver jewelry?). At any rate, if we do have an economic cave-in I believe that a drop in consumption would hurt silver, but gold would go higher (since the government would probably step-up inflation even more in an attempt to "re-print" us back into prosperity).



NOTES: I'm tired, the weather out here has now turned unbelievably beautiful (I think only an Easterner can fully appreciate San Diego's weather), everybody going past my office window is either on a bicycle, in a crazy California sports car, or carrying a surfboard. I'm knee-deep in newspapers, books and magazines. Mexico is half an hour to the south, the mountains are half an hour to the east, the ocean is five minutes to the west, and La Jolla, "the Jewel of the Pacific," is just that, one of the prettiest coast towns in the US. With the foregoing as an excuse, I'm going to take a few days off, and the next Letter will be mailed on July 11. I trust my subscribers and the various stock markets will hold out until then.